

SAN ANTONIO ESTATE PLANNING COUNCIL

April 20, 2010 – San Antonio, TX

Litigating FLP's: The Keller Decision

William R. Cousins III, CPA, J.D., LL.M.

Meadows, Collier, Reed, Cousins, Crouch & Ungerman, L.L.P.

901 Main St., Suite 3700

Dallas, Texas 75202

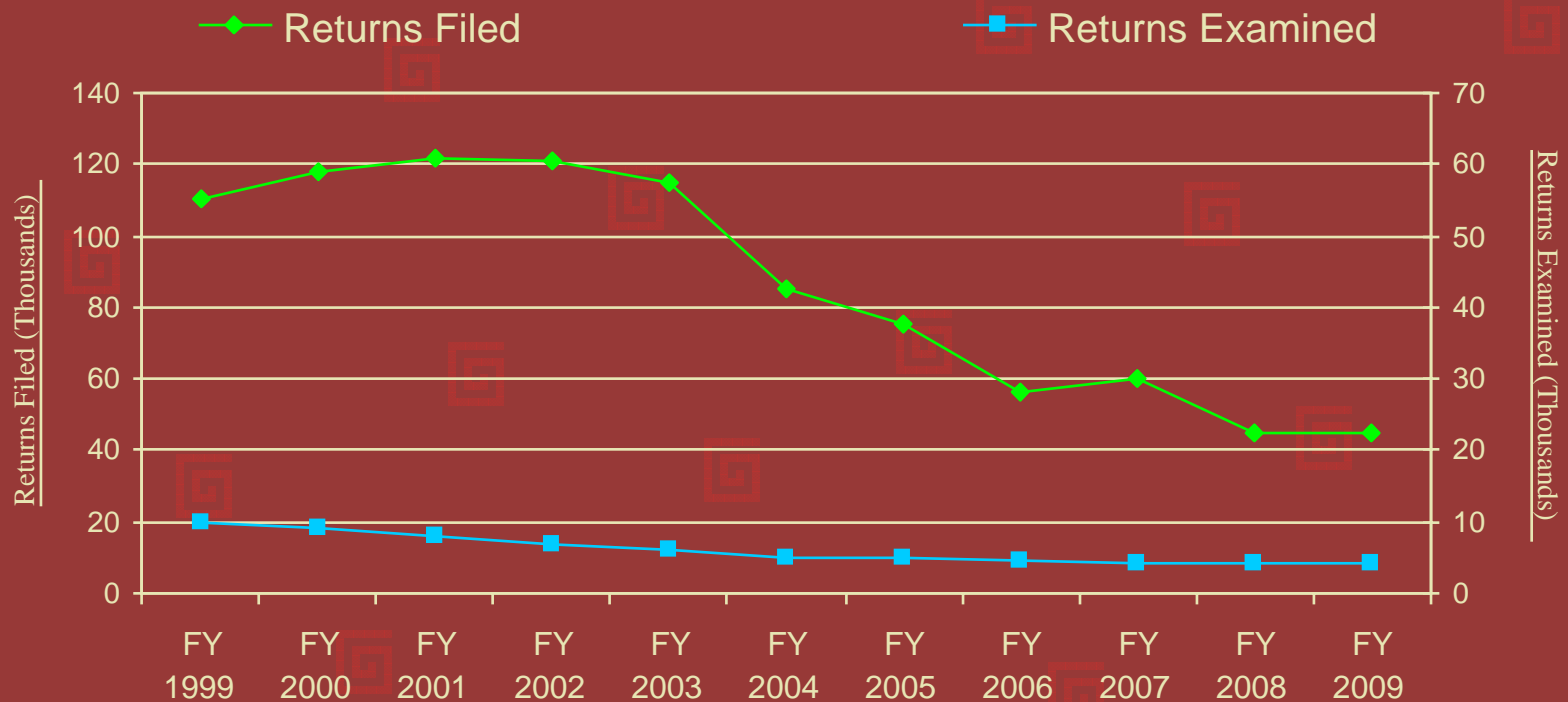
(214) 744-3700 / (800) 451-0093

TCousins@MeadowsCollier.com

www.MeadowsCollier.com

IRS Enforcement: Estate Tax Audits

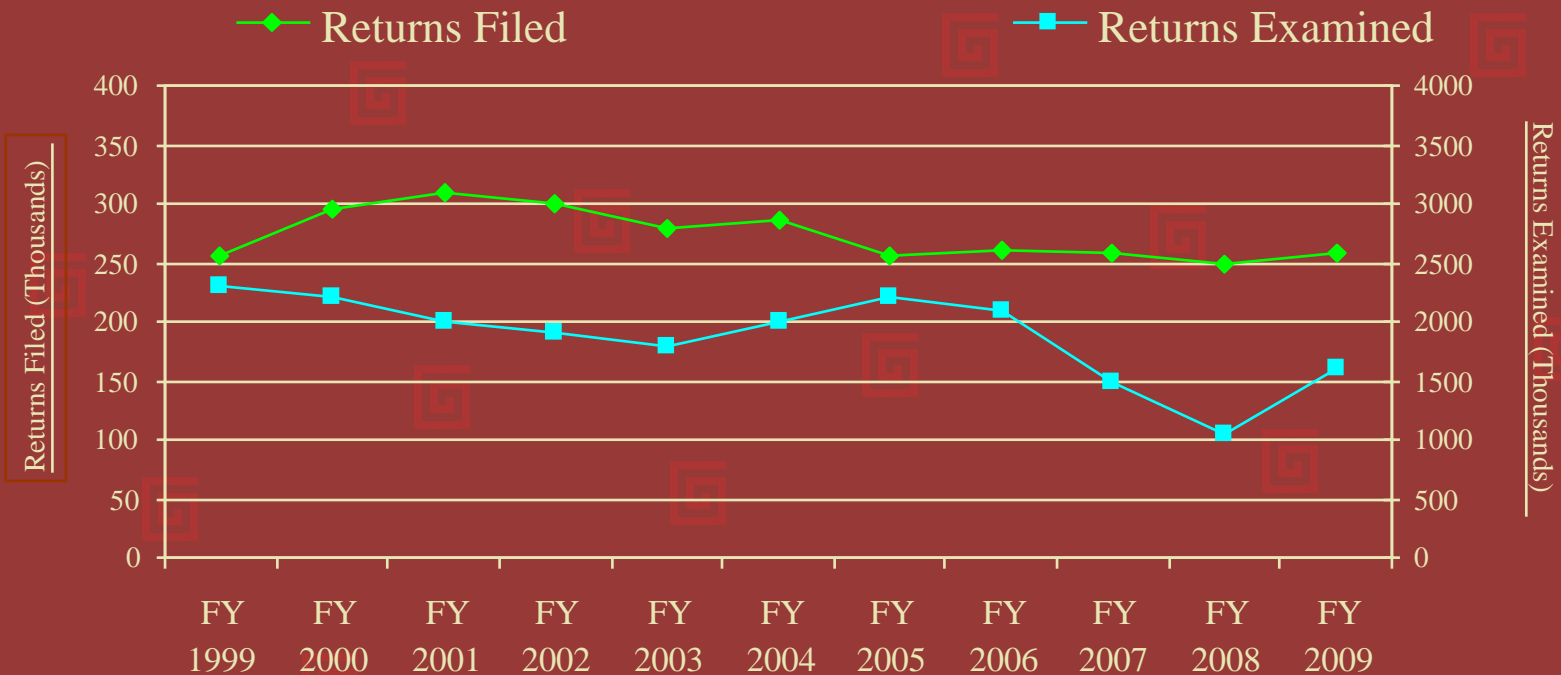
Examination Coverage of Estate Tax Returns. During FY 2008, the number of estate tax returns filed decreased by approximately 21%, and the number of returns examined decreased by almost 17%. About 1 of every 12 estate tax returns was examined.



Source: IRS Data Book.

Examination of 709's

Examination Coverage of Gift Tax Returns. The number of gift tax returns filed decreased by 3% during FY 2008. However, the number of returns examined decreased by approximately 28%.



Source: IRS Data Book.

Overall Timeline for Audit / Tax Court / Appeal

January 1, 2009: Date of Death

September 1, 2009: Estate Tax Return (706) filed without extension

March 1, 2012: Estimated completion of date for audit and issuance of Statutory Notice of Deficiency

May 1, 2012: Estate files Petition with Tax Court

April 1, 2013: Trial

Overall Timeline for Audit / Tax Court / Appeal

October 1, 2013: Post Trial Briefing Complete

October 1, 2014: Estimated Decision

December 1, 2014: Decision entered after Rule 155 calculations complete

February 1, 2015: Notice of Appeal filed

Assume 18 months to 36 months for Appeal cycle – putting “final” resolution in the mid-2016 through 2018 timeframe.



**THIS IS ONE OF THE
REASONS SO MANY CASES
SETTLE**

Assuming You Would Like to Avoid Trial and Appeal

What can you do for your client?

- At Exam, lay the basis for shifting the “burden of proof.”
- Fully utilize the Appellate Division in either a docketed or non-docketed status.
- Present superb expert testimony if the issues lend themselves to it.

Shifting the Burden of Proof Under Section 7491

- The Taxpayer must produce credible evidence;
- The Taxpayer must have complied with substantiation and recordkeeping rules;
- Must have “reasonably” cooperated in the examination process; and
- Must meet certain net worth limitations.

The IRS Appellate Division

- About 1200 Appeals Officers spread around the country;
- Independent of both the Examination Branch and the Tax Court;
- Very broad discretion to settle cases.

Experts

The Tax Court handles expert testimony uniquely:

- Pretrial depositions are very rare.
- Written reports are exchanged late in the process.
- Tax Court rules provide that the written report is the direct testimony of the expert.

You Need to Think About Your Choice of Expert Very Carefully

- No jury, so while communication skills are still very important, the “warm and cuddly” expert used to sway the jury needs to be replaced with a precise communicator.
- Without direct testimony, the report must be complete and self-explanatory – so you are looking for a good writer.

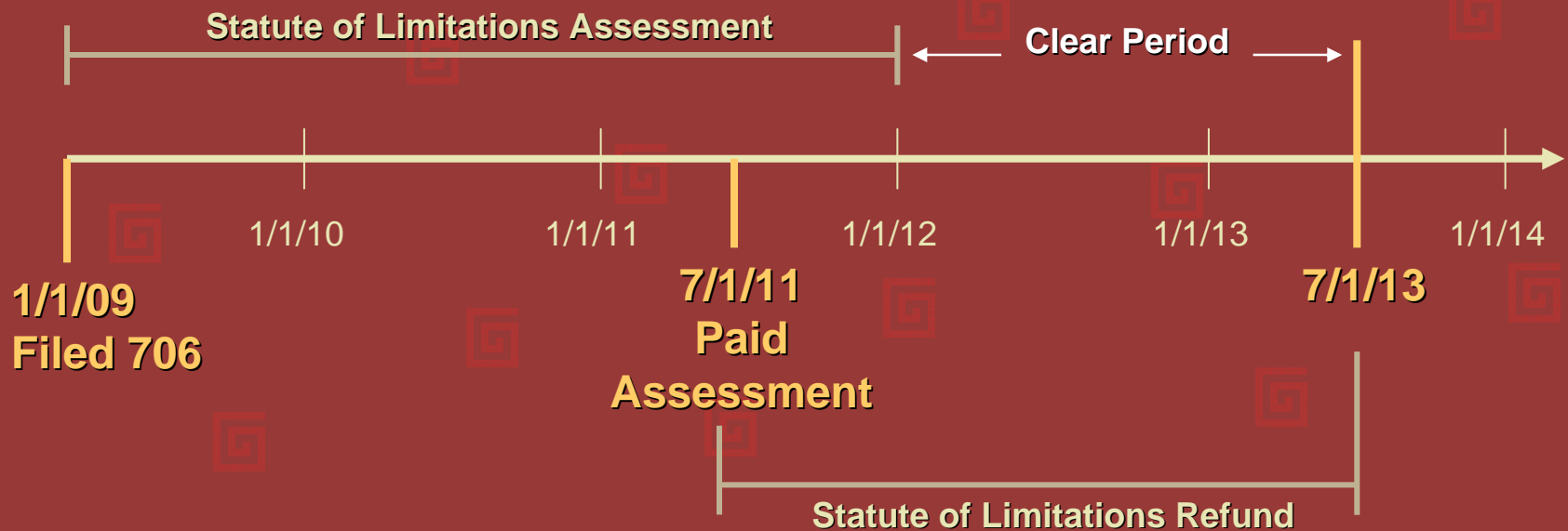
You Need to Think About Your Choice of Expert Very Carefully

- The lag between trial testimony and the Judge's consideration of the report, diminished the impact of trial theatrics.
- The Tax Court does not like advocacy by experts.
- You can blend your expert's testimony to enhance your Taxpayer's story.

When a Deal Isn't Final

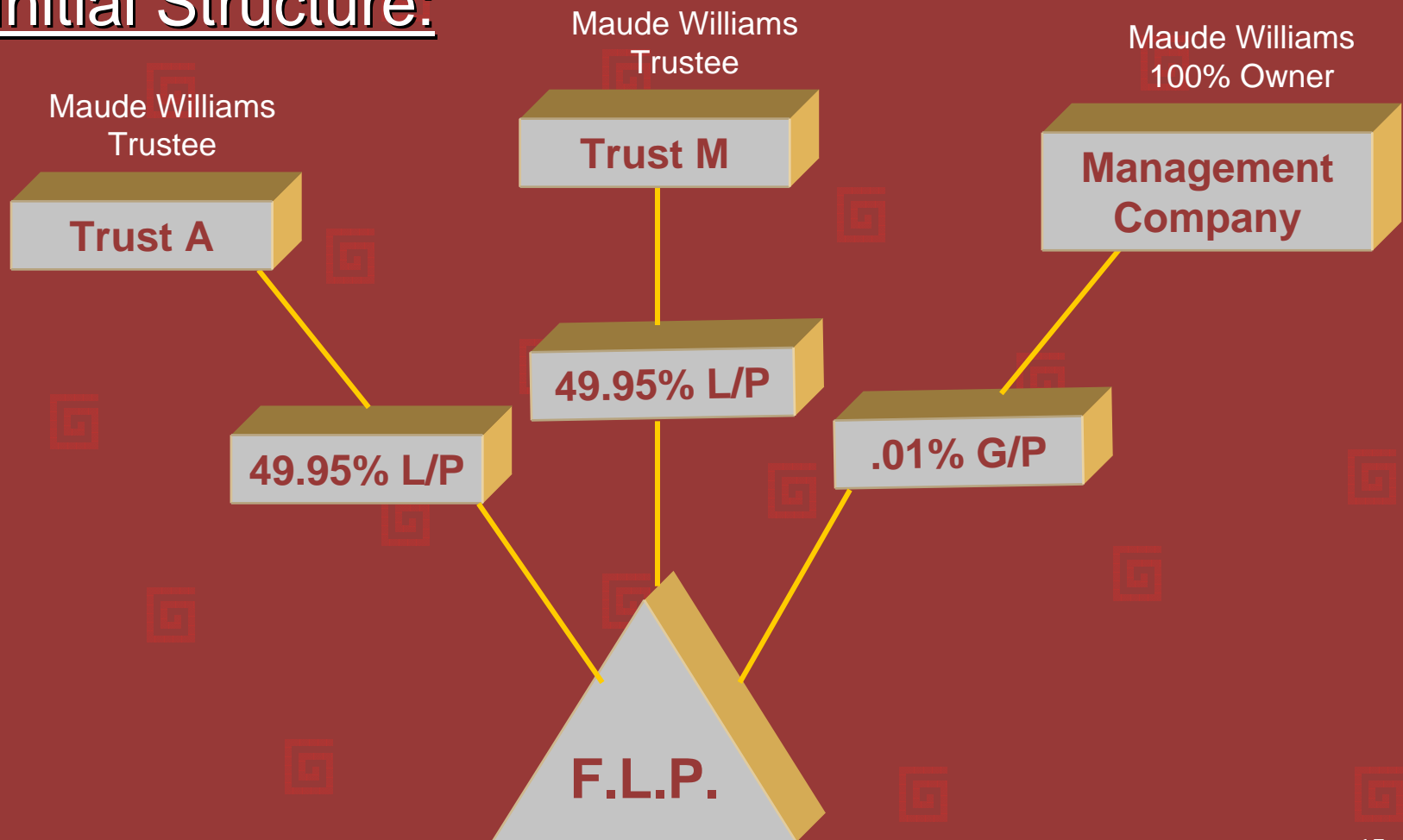
Example: Let's assume that the Estate timely files the 706 on January 1, 2009. Further that, an examination occurs resulting in a settlement, with an agreed deficiency in Estate Taxes on May 1, 2011; well within the normal 3 year statute of limitations on assessment. A Form 890 is executed, a billing generated and payment of the additional tax occurs July 1, 2011. The Estate took the settlement to limit its downside risk for additional taxes, but wanted to maintain the option of arguing for a reduction in tax. The statute of limitations on assessment will run on December 31, 2011; the refund statute of limitations will run June 30, 2013. As such there is a clear 18 month period in which a Refund Claim (Form 843) is timely, but during which it is impossible for the IRS to assert an additional deficiency (1/1/2012 through 6/30/2013). A Refund Claim filed during that period could give rise to a refund action in the U S District Court (with proper venue) 6 months after filing. In such a suit the government would be allowed to reopen the original return to create a counterclaim for additional offsetting taxes, but would not be allowed to bring suit for a net deficiency--in other words the Estate can pursue its refund with no fear of a net amount due.

When a Deal Isn't Final



Keller v. U.S.

Initial Structure:



Keller v. U.S.

Ownership of Management Company:

- To be funded with \$300,000
- Mrs. Williams verbally agrees to sell 50% interest to her daughter and 25% interests to two grandsons.

Keller v. U.S.

Documents:

- Executed prior to death:
 - Partnership Agreement with blank Exhibit A.
 - Formation documents for management company.
- Unexecuted:
 - No written assignment of C/P bonds.
 - Exhibit A to Partnership Agreement.
 - Check to fund management company.
 - No written agreements for management company stock sales.

Keller v. U.S.

Key finding of intent:

“Despite the fact that Mrs. Williams passed away before certain formalities were observed, the Court finds it clear that, at the time of her death, she intended the Community Property Bonds to be Partnership property.”

Keller v. U.S.

Intent made C/P bonds P/S property:

“Pursuant to Texas law, and as discussed below, the court finds that the Community Property Bonds were Partnership property.”...“Well-established principals of Texas law provide that the intent of an owner to make an asset partnership property will cause the asset to be property of the partnership.”

Keller v. U.S.

Obligation of Executors to complete transaction:

"In accordance with Texas law, this agreement was enforceable because, among other things, the executors of Mrs. Williams' estate had a duty to complete the transactions surrounding the general partner's formation."

Keller v. U.S.

Non-tax justification for P/S:

"It is clear to the Court that the primary purpose of these partnerships was to consolidate and protect family assets for management purposes and to make it easier for these assets to pass from generation to generation. Any estate tax savings that resulted from these partnerships were, in the Court's view, merely incidental. It is, therefore, clear to the Court that the primary purpose of these partnerships was not federal estate tax avoidance, and the actions taken to form these partnerships were not done so to create a disguised gift or sham transaction as those terms are used in estate taxation."

Keller v. U.S.

Experts:

“The Court finds that the Plaintiffs’ expert, Mr. Robert Reilly, used the correct standards in determining the fair market value of Mrs. Williams’ interests at the date of her death. The Government’s expert, Dr. Alan Shapiro, violated several of the tenets of the hypothetical buyer and seller standard, including considering the true identities of the buyer and seller, speculating as to events occurring after the valuation date, and aggregating the interests of different owners.”

DISCLAIMER

The information included in these slides is for discussion purposes only and should not be relied on without seeking individual legal advice.

IRS Circular 230 Disclosure

Information included in these slides is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding any penalties under U.S. federal tax law, or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

QUESTION AND ANSWER SESSION